United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-5006

United States Court of Appeals
FOR THE SECOND CIRCUIT

B

P/S

In the Matter

of

AMERICAN EXPRESS WAREHOUSING, LTD.,
Debtor.

BRIEF OF APPELLANT AMERICAN EXPRESS WAREHOUSING, LTD., DEBTOR

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1

TABLE OF CONTENTS

Authorities Cited

Cases

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Issue

1. Was it error for Judge Ryan to grant the application of Dunnington, Bartholow & Miller, attorneys for Scarburgh Company, Inc., for fees in connection with its representation of Scarburgh Company, Inc., a creditor in a Chapter XI proceeding, in opposing the payment of counsel fees and expenses of the Official Creditors Committee?

Statement of the Case

This is an appeal from an order of the United States District Court for the Southern District of New York issued by Judge Sylvester J. Ryan and entered March 26, 1975, granting the application of Dunnington, Bartholow & Miller ("Dunnington") for their fees in representing Scarburgh Company, Inc. ("Scarburgh"), a creditor, in opposing an application for the payment of counsel fees and expenses of the Official Creditors Committee ("OCC"). The Dunnington application sought an allowance based on claimed fees and expenses of $39,544.00. At the time of their application, the sum of $26,532.61 remained in the Debtor's

estate for distribution to all creditors pro rata. In opposing the OCC application, Dunnington appeared as counsel for Scarburgh only, and was not appointed special counsel for the creditors by the court.

On April 23, 1975, the Debtor's Notice of Appeal from the Order of Judge Ryan was filed in the United States District Court for the Southern District of New York.

Facts

After notice of the OCC application had been given to all creditors in the Debtor's Chapter XI proceeding, Dunnington, counsel for Scarburgh, a creditor and holder of an allowed claim, appeared for and on behalf of Scarburgh and opposed the application for the payment of nearly $900,000 in attorneys' fees and expenses. In the course of such representation, which was successful (Opinion No. 40787 of Judge Sylvester J. Ryan, (J. 152a))*, attorneys' fees and costs in the amount of $39,544.00 were incurred (J. 220a).

During the long pendency of these Chapter XI proceedings, the fees of the OCC attorneys were advanced from time to time by certain of the creditors pursuant to an informal agreement between such creditors and the OCC (J. 25a). These advances were generally in proportion to the amount of contributing creditors' claims, with some exceptions. Scarburgh, a substantial creditor, paid less than its proportionate share of legal costs; other creditors paid more than their proportionate share. Some creditors advanced nothing (J. 59a-60a).

The immediate effect of the application of the OCC, if it had been granted, would have been to reimburse all creditors to the extent of their respective contributions to the legal costs of the OCC (J. 58a). The ultimate effect would

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* The Joint Appendix is referred to as J., followed by the page number in the Joint Appendix.

be that each holder of an allowed claim against the Debtor's estate would bear a pro rata portion of the expense of the OCC's attorneys. The effect of a denial of the OCC application would be a monetary advantage in net distributions to those creditors which had not advanced funds for the OCC attorneys' fees, or which had not made advances proportionately with other advancing creditors. (J. 210a).

After considerable evaluation of the effect of the granting or denial of the OCC application upon the two creditor groups (i.e., contributors, as against non-contributors or disproportionately low contributors, to the OCC's legal costs) and the fact that the issue underlying the conflicting claims of the two groups had not been resolved by the courts, counsel for the Debtor concluded that an equal duty was owed to both groups of creditors which could only be met by taking no position on the merits of the OCC application or the objections thereto (J. 211a). The basic issue was whether disproportionate contribution towards the OCC's legal expenses should be a factor in distributing the assets of the estate, and equity considerations were present on both sides (J. 211a).

In connection with the OCC application, besides the appearance of Dunnington for Scarburgh in opposition, the court received objections from two other creditors, A. E. Staley Manufacturing Company (J. 123a-124a) and Amertrade Inc. (J. 139a-140a). Staley, furthermore, sought the appointment of special counsel (J. 124a), to represent the group of creditors to be affected which the court denied (J. 151a and 165a).

Argument

Point 1

Dunnington, Bartholow & Miller failed to meet all or any one of the conditions Precedent for the Award of Counsel fees.

In re Sapphire Steamship Lines, Inc., 509 F.2d 1242 (2d Cir. 1975), set forth three conditions which must be met before counsel fees can be awarded from the assets of a debtor's estate in a bankruptcy proceeding:

> (1) the trustee has refused or neglected to act;
>
> (2) the applicant has conferred a tangible benefit on all the creditors by acting in the trustee's stead; and
>
> (3) the bankruptcy court has formally authorized such attorney to act instead of the trustee.

Not one of these conditions precedent has been met by Dunnington justifying an application for counsel fees.

1. The position of the Debtor and its counsel.

Judge Ryan expressed the view that Debtor's counsel had the obligation to "act like a trustee" (J. 221a) and that counsel "should have taken a position in opposition to payment of these legal fees to the creditors' attorneys, which the Bankruptcy Act clearly prohibits" (J. 221a). Obviously, a reference to the first test of *Sapphire* is intended; however, we submit that the Court misapprehended the position of counsel and the supposed clarity of the law. We submit that the decision of Debtor's counsel, the reasoning for which is fully set forth in the record (J. 210a-212a), not to take a position between competing interests within the creditor group, did not constitute a refusal or failure to

act. In counsel's considered opinion, the application of the OCC for allowance would not adversely affect the Debtor's estate by diminishing assets available for creditors but effect only a redistribution of the estate among the eligible creditors; and the state of the law in regard to the OCC's application, especially in view of the equities involved, was far from clear. Counsel concluded that the two sides of the issue were adequately and completely represented by the opposing parties within the creditor group, and the unsettled state of the law did not justify the duplication of expenditures that an appearance in opposition would require (J. 210a-212a). Further, such expenditures by Debtor's counsel would be clearly chargeable against the estate and the fees of the opposing creditors' counsel would not. In the same vein, Debtor's counsel expressed the view that there was no need for special counsel as requested by Staley (J. 150a) and the court agreed (J. 151a) and so ordered (J. 165a). The decision of Debtor's counsel not to take a position in the dispute between the creditors was, we submit, not a refusal or failure to act but a prudent choice not to favor one side where duty was owed to both and where priority expenses payable from the Debtor's estate would be incurred.

The basic consideration underlying this decision not to oppose the application of counsel fees for the OCC was counsel's perception that whichever side ultimately won no diminishment of the Debtor's estate was involved (in the sense, say, of the effect which an exorbitant application by a trustee would have), but rather a pro rata distribution of that estate with or without the legal fees as a factor. If the OCC's legal fees were not paid there would be obvious additional benefits to those creditors who had not made pro rata contributions for legal fees (J. 186a).

If the application fees were granted, the contributing creditors would be reimbursed to the extent of their pro

rata contribution to the legal expenses of the OCC and all creditors would bear a proportionate part of such expense. If the application were denied then the assets not required for reimbursing the OCC (and ultimately the contributing creditors) would be distributed directly to all creditors pro rata to their allowed claims, with Scarburgh, in view of its minor contribution to the OCC's legal expenses (J. 59a-60a), receiving a larger than pro rata distribution in relation to major contributors to the OCC expenses. In such circumstances, we submit, the position of neufrality adopted by Debtor's counsel was the only reasonable course it could take with full awareness of its obligation of fidelity to the estate and each of its creditors.

2. Tangible benefit to the estate.

The opposition presented by Dunnington, as counsel for Scarburgh, was not motivated by nor did it result in the conferring of a tangible benefit on all the creditors, nor did counsel act in the stead of the Debtor's counsel. The only "benefit" was to those creditors who did not contribute to the OCC legal expenses or who, like Scarburgh, contributed disproportionately low amounts. The result was a disproportionately higher share in the estate for them. Nor did the opposition preserve the Debtor's estate; it merely resulted in making the distribution directly to the creditors without an adjustment based on contributions to the legal expenses of the OCC. Clearly, the opposition was advanced solely on behalf of and to gain a benefit for Scarburgh; in such posture, Dunnington was not acting in the stead of Debtor's counsel which had decided it could not take sides in an inter-creditor dispute which had merit on both sides. We now find Dunnington, to sustain its claim, "second guessing" this good faith decision by Debtor's counsel—an approach which has been decried by this Court. *In re*

Sapphire Steamship Lines, Inc., 509 F.2d 1242, 1245 (2d Cir. 1975).

3. Court appointment.

Dunnington was not appointed special counsel by the District Court. No such counsel was appointed notwithstanding a request therefor. When the issue was raised, Judge Ryan ruled that there was no need for special counsel to be appointed. "THE COURT '. . . . I see absolutely no need to appoint special counsel' " (J. 150a). Therefore, without a finding of special circumstances, the lack of court appointment is of itself sufficient ground to deny counsel fees to Dunnington. *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242, 1246 n.6 (2nd Cir. 1975).

POINT II

There are no special circumstances to justify the payment of legal fees to Dunnington, Bartholow & Miller where the District Court refused to appoint special counsel.

The special circumstances relied upon by the District Court in granting the allowance of attorneys fees to Dunnington are two-fold: the Court's view that Debtor's counsel failed to act, and that tangible benefit was conferred upon *all* the creditors. We submit that these are not "special circumstances." Rather they are mere restatements of the first two conditions precedent for the allowance of fees. If such were the meaning given by this Court to "special circumstances" in *Sapphire* then its requirement of appointment by the Court as special counsel becomes a meaningless condition. It was just such situations which this Court in *Sapphire* rejected as special circumstances. The example used by this Court, and cited by

the District Court, as an example of "special circumstances" was the case of *In re New York Investors, Inc.* 130 F.2d 90 (2d Cir. 1942), where "objecting counsel . . . had successfully opposed exhorbitant fee applications of the trustee and his counsel which the trustee would not oppose." *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242, 1246 (2d Cir. 1975), citing *In re New York Investors, Inc.*, 130 F.2d at 92. In fact, this Court went so far as to say: ". . . From . . . the time of [*In re New York Investors, Inc.*] the rule of this Circuit has been that the prior approval requirement is waived only in cases where compensation is sought for opposing allowances to trustees and their counsel." *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242, 1246, n.6 (2d Cir. 1975).

The District Court incorrectly analogized the situation in *New York Investors, Inc.* to the application of the OCC for counsel fees. The analogy fails on two counts: 1) while it is true that the OCC could not be expected to oppose its own application (just as the trustee in *New York Investors* would not), it is not true that the Debtor's or its counsel's fiduciary obligation to each creditor compelled either of them to take a position against the application. See pp. 4-6 *supra*. 2. Unlike the trustee in bankruptcy in *New York Investors, Inc.*, counsel for the Debtor did not refuse to act because to act would clearly be against its own interest as applicant for fees, but took the position it did because of its view that the competing interests among the members of the OCC would resolve the equitable question of whether the disproportionate contributions of creditors to the legal expenses of the OCC should be a factor in effecting a pro rata distribution of the debtor estate. Unlike *New York Investors*, where a serious diminishment of the bankrupt estate would result from granting the trustee's application for fees, the only issue

in the OCC application was the equitable distribution of the Debtor's estate to the creditors.

Finally, the Court below apparently failed to see that, in the circumstances of the OCC application, no general benefit to all creditors resulted from the disallowance. Some, who had advanced large sums to the OCC for legal expenses, were considerably disadvantaged (J. 59a-69a). See pp. 5-6 *supra*.

POINT III

The finding of the District Court of failure to act on the part of debtor's counsel is without basis in the record.

In Judge Ryan's decision, he stated: "Surprisingly the attorney for the debtor did not oppose [the allowance of counsel fees to the OCC]." (J. 220a). The Court, in the hearing on the application of the OCC for counsel fees, at no time requested of counsel for the Debtor any comment or argument on the application, and as set forth on pp. 4-5 *supra*, counsel for the Debtor was not in a position to argue the point since its resolution involved an inter-creditor dispute. The surprise of the Court is at best a bit delayed.

Secondly, the Court presents no basis for the conclusion that "the attorney for the Debtor [failed] to act like a Trustee [and] . . . should have taken a position in opposition to payment" (J. 221a). The contrary is true: by refusing to take a position among competing interests the counsel for the Debtor made a lawyer's judgment, which as a matter of policy should not be second-guessed in aid of an award to counsel for a creditor. *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242, 1245 (2d Cir. 1975).

Finally, the action taken by Dunnington was not action which should have been taken by counsel for the Debtor,

but action its client chose to take to carve a larger slice out of the distributable assets. Its motives were not the motives of a fiduciary, but those of a distributee—and one who stood to gain over other distributees if the opposition was successful. Dunnington never asked to represent the creditors as a whole, nor could they, because they only represented one member of a group to be affected.

CONCLUSION

For the reasons set forth above, the Order of the United States District Court for the Southern District of New York by the Honorable Sylvester J. Ryan entered March 26, 1975, granting the application of Dunnington, Bartholow & Miller for counsel fees in representing Scarburgh Company, Inc. in opposing the application of the Official Creditors' Committee for counsel fees and expenses, should be reversed.

Respectfully submitted,

Cadwalader Wickersham & Taft
Attorneys for Appellant
American Express Warehousing, Ltd.,
Debtor

Jacquelin A. Swords
John J. Walsh
Of Counsel

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In the Matter of	:	Index No. 75-5006
AMERICAN EXPRESS WAREHOUSING, LTD.,	:	
	:	
Debtor.	:	AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

JOHN G. WHELLEY, JR., first being duly sworn, deposes and says that:

1. He is at least eighteen years of age;

2. He is not a party of interest to the above-captioned matter; and

3. He has served upon the Appellees in the above-captioned matter two copies of the Brief for the Appellant and the Joint Appendix by mailing first-class, postage prepaid, to Dunnington, Bartholow & Miller, attorneys for the Appellees, Dunnington, Bartholow & Miller and Scarburgh Company, Inc., 161 East 42nd Street, New York, New York 10017.

John G. Whelley, Jr.

Sworn to before me this
30th day of June, 1975.

Karen W. Michelson
Notary Public
KAREN W. MICHELSON
Notary Public, State of New York
No. 31-4514262
Qualified in New York County
Commission Expires March 30, 1977